

Internal Revenue Service, Treasury

§ 4.954-1

Step 1—Determine gross income:

- (1) Gross income\$1000

Step 2—Compute gross foreign base company income and gross insurance income:

- (2) Gross foreign base company income and insurance income as defined in sections 954(c), (d), (e), (f), (g) and 953 and the regulations thereunder (interest income)720

Step 3—Compute adjusted gross foreign base company income:

- (3) Seventy percent of gross income (.70 × line (1))700
 (4) Adjusted gross foreign base company income or insurance income after the application of the full inclusion rule of this paragraph (b)(1) (line (2), or line (1) if line (2) is greater than line (3))1000
 (5) Full inclusion foreign base company income under paragraph (a)(2)(vi) (line (4) minus line (2))280

Step 4—Compute net foreign base company income:

- (6) Related person interest expense and other deductions allocable and apportionable to foreign personal holding company income under section 954(b)(5) and paragraph (c)400
 (7) Deductions allocable and apportionable to full inclusion foreign base company income under section 954(b)(5) and paragraph (c)250
 (8) Foreign personal holding company income after allocating deductions under section 954(b)(5) and paragraph (c) of this section (line (2) reduced (but not below zero) by line (6))320
 (9) Full inclusion foreign base company income after allocating deductions under section 954(b)(5) paragraph (c) of this section (line (5) reduced (but not below zero) by line (7))30
 (10) Total gross foreign base company income after allocating deductions under section 954(b)(5) and paragraph (c) (line (8) plus line (9))350

Step 5—Compute net insurance income:

- (11) Net insurance income under section 953 and the regulations thereunder0

Step 6—Compute adjusted net foreign base company income:

- (12) Foreign tax imposed on foreign personal holding company income

(interest)120

- (13) Foreign tax imposed on full inclusion foreign base company income2
 (14) Ninety percent of the maximum U.S. corporate tax rate30.6
 (15) Effective rate of foreign tax imposed on \$320 of foreign personal holding company income under section 954(b)(4) and paragraph (d) (line (12) divided by line (8))38
 (16) Effective rate of foreign tax imposed of \$30 of full inclusion foreign base company income under section 954(b)(4) and paragraph (d) (line (13) divided by line (9))7
 (17) Foreign personal holding company income subject to a high foreign tax under section 954(b)(4) and paragraph (d) (zero, or line (8) if line (15) is greater than line (14))320
 (18) Full inclusion foreign base company income subject to a high foreign tax under section 954(b)(4) and paragraph (d) (zero, or line (9) if line (16) is greater than line (14))0
 (19) Adjusted net foreign base company income after applying section 954(b)(4) and paragraph (d) (line (10), reduced by the sum of line (17) and line (18))30

Step 7—Compute adjusted net insurance income:

- (20) Adjusted net insurance income0

Step 8—Additions to or reduction of adjusted net foreign base company income by reason of section 952(c):

- (21) Earnings and profits for the current year350
 (22) The excess in earnings and profits over subpart F income, which is subject to being recharacterized as adjusted net foreign base company income under section 952(c)(2) (excess of line (21) over the sum of line (19) and line (20)); if there is a deficit, then the limitation of 952(c)(1) may apply for the current year320
 (23) Amount of reduction in subpart F income for prior taxable years by reason of the limitation of section 952(c)(1) and the regulations thereunder600
 (24) Subpart F income as defined in section 952(a), assuming section 952(a) (3), (4), or (5) does not apply (the sum of line (19) and line (20) plus the lesser of line (22) or line (23))350
 (25) Amount of prior years' deficit remaining to be recharacterized as subpart F income in later years

under section 952(c) (excess of line (23) over line (22))280

(c) *Computation of net foreign base company income*—The net foreign base company income of a controlled foreign corporation is computed by reducing (but not below zero) the amount of gross income in each of the categories of adjusted gross foreign base company income described in paragraph (b)(2) of this section, so as to take into account deductions allocable and apportionable to such income. For purposes of section 954 and this section, expenses must be allocated and apportioned consistent with the allocation and apportionment of expenses for purposes of section 904(d). For purposes of this §1.954-1T, an item of net foreign base company income must be categorized according to the category of adjusted gross foreign base company income from which it is derived. Thus, an item of net foreign base company income must be categorized as a net item of—

- (1) Foreign personal holding company income,
- (2) Foreign base company sales income,
- (3) Foreign base company services income,
- (4) Foreign base company shipping income,
- (5) Foreign base company oil related income, or
- (6) Full inclusion foreign base company income.

(d) *Computation of adjusted net foreign base company income or adjusted net insurance income*—(1) *Application of high tax exception*. Adjusted net foreign base company income (or adjusted net insurance income) equals the net foreign base company income (or net insurance income) of a controlled foreign corporation, reduced by any item of such income (other than foreign base company oil related income as defined in section 954(g)) subject to the high tax exception provided by section 954(b)(4) and this paragraph (d). An item of income is subject to the high tax exception only if—

- (i) It is established that the income was subject to creditable income taxes imposed by a foreign country or countries at an effective rate that is greater than 90 percent of the maximum rate of tax specified in section 11 or 15 for the

taxable year of the controlled foreign corporation; and

- (ii) An election is made under section 954(b)(4) and paragraph (d)(5) of this section to exclude the income from the computation of subpart F income.

See paragraph (d)(4) of this section for the definition of the term “item of income.” For rules concerning the treatment for foreign tax credit purposes of amounts excluded from subpart F under section 954(b)(4), see §904-1.4(c)(1).

(2) *Effective rate at which taxes are imposed*. For purposes of this paragraph (d), the effective rate at which taxes are imposed on an item of income is—

- (i) The amount of income taxes paid or accrued (or deemed paid or accrued) with respect to the item of income, determined under paragraph (d)(3) of this section, divided by

(ii) The item of net foreign base company income or net insurance income, determined under paragraph (d)(4) of this section (including the appropriate amount of income taxes referred to in subdivision (i) of this paragraph (d)(2), immediately above).

(3) *Taxes paid or accrued with respect to an item of income*—(i) *Income other than passive foreign personal holding company income*. The amount of income taxes paid or accrued with respect to an item of income (other than an item of foreign personal holding company income that is passive income) for purposes of section 954(b)(4) and this paragraph (d) is the amount of foreign income taxes that would be deemed paid under section 960 with respect to that item if that item were included in the gross income of a U.S. shareholder under section 951(a)(1)(A). For this purpose, the amounts that would be deemed paid under section 960 shall be determined separately with respect to each controlled foreign corporation and without regard to the limitation applicable under section 904(a).

(ii) *Passive foreign personal holding company income*. The amount of income taxes paid or accrued with respect to an item of foreign personal holding company income that is passive income for purposes of section 954(b)(4) and this paragraph (d) is the amount of foreign income taxes paid or accrued or deemed paid by the foreign corporation